

**Statement of
Steven A. Kandarian
Executive Director
Pension Benefit Guaranty Corporation**

before the

**Committee on Finance
United States Senate
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Chairman Baucus, Senator Grassley, and Members of the Committee:

Good afternoon. I appreciate the opportunity to appear before you today. I became Executive Director of the PBGC on December 3, 2001, just three months ago, and look forward to working closely with this Committee.

My testimony this afternoon will address the Enron Corporation's defined benefit pension plans that are insured by the Pension Benefit Guaranty Corporation (PBGC).

Pension Benefit Guaranty Corporation

Background

I would like to take a few minutes to give you some background on the PBGC and its role in the pension system. PBGC was created by ERISA, the Employee Retirement Income Security Act of 1974, to guarantee private defined benefit pension plans that terminate without sufficient assets. Defined benefit plans provide a monthly retirement benefit, usually based on salary and years of service. The benefit amount does not depend on investment performance.

PBGC is one of the three so-called "ERISA agencies" with jurisdiction over private pension plans. The other two agencies are the Department of the Treasury (including the Internal Revenue Service) and the Department of Labor's Pension and Welfare Benefits Administration (PWBA). Treasury and PWBA deal with both defined benefit plans and defined contribution plans, including 401(k) plans. PBGC deals only with defined benefit plans, and only to a limited extent, as guarantor of benefits in underfunded plans that terminate. PBGC has very limited regulatory or enforcement authority over ongoing plans; the authority PBGC does have relates to

certain employer reporting requirements and to determining whether a plan should be terminated to protect the insurance program.

PBGC protects the benefits of about 44 million participants and beneficiaries in slightly more than 35,000 ongoing defined benefit pension plans. When a plan insured by PBGC terminates without sufficient assets, PBGC becomes trustee of the plan and pays plan benefits, subject to statutory limits. For the vast majority of participants in PBGC-trusted plans, plan benefits are paid in full. Currently, PBGC is responsible for paying current or future benefits to about 624,000 people in terminated plans, with payments, for the first time, exceeding \$1 billion in 2001.

PBGC is a wholly-owned federal government corporation. It operates under the guidance of a three-member Board of Directors – the Secretary of Labor, who is the Chair, and the Secretaries of Commerce and Treasury.

PBGC receives no funds from general tax revenues. Operations are financed by insurance premiums set by Congress and paid by sponsors of defined benefit plans, assets from pension plans trusted by PBGC, investment income, and recoveries from the companies formerly responsible for the trusted plans. There is a two-part annual premium for single-employer plans – a flat-rate premium of \$19 per plan participant plus a variable-rate premium of \$9 per \$1,000 of the plan's unfunded vested benefits. PBGC has a separate, smaller insurance program for multiemployer plans, which are collectively bargained plans maintained by two or more unrelated employers.

PBGC's statutory mandate is: (1) to encourage the continuation and maintenance of voluntary private pension plans for the benefit of their participants, (2) to provide for the timely and uninterrupted payment of pension benefits to participants and beneficiaries under PBGC-insured plans, and (3) to maintain premiums at the lowest level consistent with carrying out the agency's statutory obligations. PBGC strives to provide superior customer service to plan participants and premium payers.

Financial Condition of the PBGC

For its first 21 years, PBGC operated at a deficit, but gradually built up a surplus beginning in 1996 as a result of legislative reforms, a strong economy, good returns on investments, and no major terminations from 1996-2000. PBGC had a surplus of almost \$10 billion in its single-employer program at the end of fiscal 2000 (September 30, 2000). At the end of fiscal 2001 (September 30, 2001), the surplus had dropped to approximately \$7.7 billion. This year, we already know that PBGC will experience the largest claim in its history, in excess of \$1 billion, when we become trustee of the LTV Steel pension plans. And we continue to face significant exposure from troubled companies with underfunded pension plans, especially in the steel, airline, and retail sectors.

Large plan terminations have always been, and continue to be, the single most important factor determining PBGC's workload as well as its financial condition. PBGC took in 104 plans with 89,000 participants last year, the largest number of participants in PBGC's 27-year history. We project about 180,000 new participants this year, more than double last year's record, as a result of the LTV Steel plans and other terminations.

PBGC's Exposure to Loss from Enron Pension Plans

Mr. Chairman, you asked me to address PBGC's exposure to loss if the Enron pension plans terminate. Most of the public focus has been on Enron's 401(k) and employee stock ownership plans. These plans are not defined benefit plans and so are not insured by PBGC.

However, there are at least three defined benefit plans insured by PBGC in the Enron corporate group – the underfunded Enron Corporation Plan ("Enron Plan"), currently named the Enron Corporation Cash Balance Plan, and two others that are fully funded on a termination basis, based on the most recent actuarial information we have. The Enron corporate structure and history are complex, and we are still gathering information as to whether there are other defined benefit plans within the Enron corporate group. To date, PBGC has not taken over any Enron plans, but we are closely monitoring the situation.

PBGC estimates that the Enron Plan, with about 20,000 participants, has approximately \$220 million in assets and is underfunded by at least \$125 million on a PBGC termination basis. This estimate will change over time as a result of market movements in interest rates and asset performance. Of course, PBGC will not assume any pension obligations or sustain a loss if the Enron plans remain ongoing.

PBGC is sometimes asked why plan underfunding on a PBGC termination basis varies from what the plan has calculated on an ongoing plan basis. PBGC values pension obligations in terminated plans using actuarial assumptions designed to replicate the price of purchasing an annuity for the terminating plan in the private market. In contrast, companies are permitted to use assumptions appropriate for ongoing plans, within specified limits, to value their pension obligations for plan funding and financial reporting purposes.

One of the most significant actuarial assumptions is expected retirement age, which can change markedly at plan termination. Typically, employers sponsoring terminating plans are shutting down their operations. Employees who are eligible for unreduced (or partially reduced) early retirement benefits are more likely to retire early, thus increasing the plan's pension obligations. As a result of the differences in actuarial assumptions for ongoing plans and terminating plans, a plan may be better funded when valued on an ongoing basis than on a termination basis.

Enron Corporation Defined Benefit Pension Plan

The Enron Plan is currently a cash balance plan but has had a variety of benefit formulas in its history. The plan started out as a traditional final average pay plan, switched to an arrangement known as a “floor-offset Employee Stock Ownership Plan (ESOP),” which I will describe later, and finally became a cash balance plan. None of the changes in benefit formula affected benefits earned in prior years. Thus, a person who worked for Enron under all three arrangements has a defined benefit pension consisting of three separate components.

Final average pay plan (benefits earned before 1987). The Enron Retirement Plan was established on July 1, 1986. The plan was a successor of the InterNorth Corporation Plan (“InterNorth Plan”), which started in 1938, and the Houston Natural Gas Corporation Plan (“Houston Plan”), which was started in 1946. The InterNorth Plan, the Houston Plan, and the successor Enron Retirement Plan were “traditional” defined benefit plans. Benefits were calculated using employees’ years of service and final average pay.

Immediately before the InterNorth Plan and Houston Plan merged to form the Enron Plan, the InterNorth Plan split into two plans: one for terminated vested participants and the other for retired and active participants and beneficiaries. Enron then closed out the InterNorth Plan for terminated vested participants, providing Enron a reversion of about \$230 million in 1987.

Enron transferred the \$230 million reversion to the Enron ESOP. The Enron ESOP was started in 1986 with a purchase of Enron stock, financed by a \$335 million loan from Enron. The Enron ESOP used the \$230 million reversion to partially repay the loan from Enron.

Floor-offset ESOP (benefits earned 1987 - 1994). Effective January 1, 1987, Enron amended the Enron Retirement Plan to have a floor-offset ESOP arrangement. The floor-offset arrangement did not affect benefits earned before 1987 or those earned after 1994 when the floor-offset arrangement was ended.

Under the floor-offset arrangement, the benefit computed under the final pay formula was “offset” by the benefit amount the ESOP account could provide. For example, consider a participant who began working for Enron during the years the floor-offset arrangement was in effect. Assume the participant’s final pay formula benefit is \$600 per month, and the ESOP is able to provide \$400 per month at retirement. The participant would receive the ESOP account plus \$200 per month from the defined benefit plan (\$600 minus the \$400 ESOP offset). As this example shows, the participant would receive a combined benefit that was never less than the benefit under the final pay formula (“the floor”). If the ESOP is able to provide more than \$600 per month, the participant would receive the entire ESOP account but would not be entitled to a benefit from the defined benefit plan (because the \$600 was fully offset by the ESOP).

Fixing of ESOP offset value and release of ESOP shares for non-retired participants.

In 1994, Enron froze the accrued benefits under the final pay formula (the floor) and also set up an arrangement to lock in the stock price of the ESOP offset over a five-year period. Each year for five years (1996 - 2000) the value of 20% of the ESOP stock (the offset) was fixed at the then current market value and the shares were released to the participants. The percentage was higher for those who were age 50 or older or retired. Future changes in the stock's value did not affect the part of the offset that had been fixed. PBGC is not aware of other ESOP offset plans that have fixed the value of the ESOP stock in computing the offset.

While we are still checking the details, it appears that after the Enron stock was released participants could sell it, if they wished, either at the time of the release or at monthly intervals in the future. Terminated vested and retired employees were given the choices of leaving the Enron stock in the ESOP (the default), receiving a distribution of the ESOP stock, transferring the shares to an IRA (where they could be sold), or using the proceeds of the sale of the ESOP stock to purchase an annuity from an insurance company. Active participants had the same options and, in addition, could transfer the stock to the Enron 401(k) plan, where the shares could be liquidated and the proceeds reinvested in other investments offered by the 401(k) plan.

Cash Balance formula (benefits earned after 1994). In 1996, the Enron Plan was amended to adopt a cash balance design. Accruals under the cash balance formula began on January 1, 1996, with an annual 5% salary credit and a monthly interest credit of the 10-Year Treasury rate from the preceding month. There were originally no accruals for 1995 in the plan, under either the old offset design or the cash balance design. The ESOP plan had incorporated a special allocation to compensate for this lack of accrual. This special allocation was made over two years. In addition, in 1997, an extra credit was applied to employees' cash balance accounts to make up for the smaller-than-expected special 1995 ESOP allocation.

Floor-Offset ESOPs

Enron's floor-offset arrangement is not common. The Omnibus Budget Reconciliation Act (OBRA) of 1987 generally banned ESOP offset arrangements in which more than 10% of the combined asset values of the defined benefit plan and the ESOP plan are invested in employer securities. However, OBRA contained a "grandfather" provision that permitted ESOP offset arrangements that were already in existence to remain in effect. Enron's floor-offset ESOP arrangement and those of about 150 other companies were permitted under the "grandfather" provision.

Thank you, Mr. Chairman. I would be pleased to answer questions from the Committee.